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No. 80-152

IN THE

Supreme Court of the United States

October Term, 1980

MARINE BANK,

Petitioner,

vs.

SAMUEL WEAVER and ALICE WEAVER,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Questions Presented

FIRST QUESTION:

Whether Weaver's pledge of his $50,000 Certificate of Deposit to Marine, for purposes of Weaver acquiring an investment position in Columbus, constituted the purchase and sale of a security within Section 17(a) of the Securities Act of 1933 and Section 10b-5 of the Securities Exchange Act of 1934.

SECOND QUESTION:

Whether Piccirillo's written promise to pay Weaver 50% of the profits of Columbus in consideration for Weaver's pledge of his $50,000.00 Certificate of Deposit to Marine, was a security within §10b-5 of the Securities Exchange Act of 1934 and §17(a) of the Securities Act of 1933.

Page

TABLE OF CONTENTS.

	Page
Questions Presented	i
Cases Cited	ii
Counterstatement of Facts	1
Reasons for Denying the Writ	6
First Question: Whether Weaver's pledge of his $50,000 Certificate of Deposit to Marine, for purposes of Weaver acquiring an investment position in Columbus, constituted the purchase and sale of a security within Section 17(a) of the Securities Act of 1933 and Section 10b-5 of the Securities Exchange Act of 1934	6
Second Question: Whether Piccirillo's written promise to pay Weaver 50% of the profits of Columbus in consideration for Weaver's pledge of his $50,000.00 Certificate of Deposit to Marine, was a security within §10b-5 of the Securities Exchange Act of 1934 and §17(a) of the Securities Act of 1933	11
Conclusion	16

CASES CITED.

Affiliated UTE Citizens v. United States, 406 U.S. 128 (1972) 14,16

Amfac Mfg. Corp. v. Arizona Mall of Tempe, 583 F.2d 426 (9th Cir., 1978) 9

Bellah v. First National Bank of Hereford, Texas, 495 F.2d 1109 (5th Cir., 1974) 8

Burrus, Cootes and Burrus v. MacKethan, 537 F.2d 1262 (4th Cir., 1976) 8

Cameron v. Outdoor Resorts of America, 608 F.2d 187 (5th Cir., 1979) 11,12

Page

Canadian Imperial Bank of Commerce Trust Company v. Fingland, 615 F.2d 465 (7th Cir., 1980)... 8
C.N.S. Enterprises, Inc. v. G & G Enterprises, Inc., 508 F.2d 1354 (7th Cir., 1975) 9
Ernst and Ernst v. Hochfelder, 425 U.S. 185 (1976) . 15
Great Western Bank and Trust Co. v. Kotz, 532 F.2d 1252 (9th Cir., 1976)..... 14
Hirk v. Agri-Research Council, Inc., 561 F.2d 96 (7th Cir., 1977)..... 13
Lino v. City Investing Co., 487 F.2d 683 (3rd Cir., 1973)..... 12,14
Matheson v. Armbrust, 284 F.2d 670 (9th Cir., 1960) 14
McClure v. First National Bank of Lubbock, Texas, 497 F.2d 490 (5th Cir., 1974) 7
Milnarik v. M-S Commodities, Inc., 457 F.2d 274 (7th Cir., 1972)..... 13
Rubin v. U.S., _____ U.S. _____, 100 S. Ct. 698 (1981)..... 6,7,10,16,17
S.E.C. v. Addison, 194 F.Supp. 709 (N.D. Tex. 1979)..... 12
S.E.C. v. C.M. Joiner Leasing Company, 320 U.S. 334 (1943)..... 11,16
S.E.C. v. Continental Commodities Corporation, 497 F.2d 516 (5th Cir., 1974)..... 13
S.E.C. v. W.J. Howey Co., 328 U.S. 293 (1946)... 10,11,12, 13,14,16
Superintendent of Insurance v. Bankers Life and Casualty Company, 404 U.S. 6 (1971)..... 14
Tcherepnin v. Knight, 389 U.S. 332 (1967) 10,11,12,16
Wasnowic v. Chicago Board of Trade, 352 F.Supp. 1066 (M.D. Pa. 1972), *aff'd. mem.*, 491 F.2d 752 (3rd Cir., 1973), *cert. denied*, 416 U.S. 994 (1974).. 13
Zabriskie v. Lewis, 507 F.2d 546 (10th Cir., 1974)..... 10

Page

STATUTES CITED.

Securities Act of 1933, 15 U.S.C. §77(b)(1) 11
Securities Act of 1933, 15 U.S.C. §77q(a) 5,6,7,11
Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10) 11
Securities Exchange Act of 1934, 15 U.S.C. §78j(b) 5,6,11
Pennsylvania Securities Act, Pa. Stat. Ann. Tit. 70, §1-101, *et seq.* (Purdon Supp. 1980)..... 5

RULE CITED.

Federal Rules of Civil Procedure, Rule 56 5,6,9

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Counterstatement of Facts

Samuel and Alice Weaver, hereinafter referred to as "Weaver", claim that Marine Bank, hereinafter referred to as "Marine", induced Weaver to become involved in an investment or securities transaction as a consequence of material misrepresentations intentionally made by Marine to Weaver to induce Weaver's involvement. The subject matter of this claim relates to what both Weaver and Marine considered as a $50,000.00 investment by Weaver in a wholesale slaughterhouse and retail meat store operated by Columbus Packing Company, hereinafter referred to as "Columbus."

Columbus was a proprietorship operated by Raymond and Barbara Piccirillo. From May of 1976 through December of 1977, Marine made three separate loans to Columbus in the amounts of $10,000.00; $20,000.00; and $3,350.00 for a total of $33,350.00. Columbus was unable to make the principal and interest payments on these loans at all material times in 1977 and 1978. Columbus was insolvent at all material times from October of 1977 through March 17, 1978. As of December of 1977, Columbus's checking account had been overdrawn 189 times since May 7, 1976 and was overdrawn in the amount of $9,345.02 as of that date. That checking account remained continuously overdrawn through March 17, 1978.

In late 1977 and early 1978, Marine had exhausted all its rights as the commercial banker for Columbus to either collect its loans from Columbus and/or to correct the overdrawn checking account of Columbus. In September of 1977, the United States Small Business Administration refused to loan Columbus any money for working capital. When Marine made loans to Columbus, it intended to perfect its position through Uniform Commercial Code filings against Columbus's equipment. However, because it failed to properly file its liens, it could not sell the Columbus equipment to satisfy these loans.

In February and March of 1978, Weaver was approached by both Piccirillo and Marine representatives responsible for the Columbus account to invest in Columbus. Sam Weaver, then aged 79, and Alice Weaver, 71, were farmers. Since 1976, they had conducted a livestock auction in Union City, Erie County, Pennsylvania. They had

no formal education beyond the 8th Grade. They had little or no interest in making any investment in Columbus until being solicited to do so by Piccirillo and the representatives of Marine.

Weaver, on February 28, 1978, had withdrawn $50,000.00 from another bank and purchased a $50,000.00 Certificate of Deposit at Marine for investment purposes and possibly as working capital for his livestock business. This Certificate had a maturity date of six years with interest at 6%. Piccirillo and Marine were aware of Weaver having this $50,000.00 Certificate of Deposit and Marine persuaded Weaver to pledge this $50,000.00 Certificate of Deposit to Marine on the representation that Marine would make a $65,000.00 loan to Columbus and that all and/or substantially all of the $65,000.00 loan would be made available to Columbus for working capital. Marine also represented that Marine had an adequate collateral position on Columbus's equipment to protect Weaver's $50,000.00 Certificate of Deposit and that Marine would provide Weaver with a monthly profit and loss statement of Columbus so that Weaver could monitor his investment. Marine failed to disclose to Weaver that Columbus was insolvent; that Columbus had failed to make the interest and principal payments on the prior loans; that Columbus's checking account was in a continuous overdrawn position from 1977 through March 17, 1978; that Columbus would continue to be insolvent after Marine made this $65,000.00 loan; and that very little of this money would be available to Columbus for working capital.

Weaver pledged his $50,000.00 Certificate of Deposit to Marine on March 17, 1978. Marine made the $65,000.00 loan to Columbus on that date. On the same

day, Weaver, as consideration for pledging the $50,000.00 Certificate of Deposit to Marine, executed a written agreement with Columbus which gave Weaver the right, among other things, to receive 50% of the "adjusted net profits" of Columbus so long as the Certificate of Deposit remained pledged to Marine. Marine was not specifically aware of the terms of the agreement which Weaver executed with Columbus on March 17, 1978, but Marine's officers handling this transaction testified in their pre-trial deposition that they considered Weaver as an investor in Columbus and that the amount of his investment was the $50,000.00 which he pledged on March 17, 1978.

On March 17, 1978, Marine distributed the proceeds of the $65,000.00 loan by paying $12,068.56 to various creditors of Columbus who had put Marine on notice of claims; $42,978.38 to itself to cover the three past loans and the accrued interest; $7,758.77 to itself to reimburse the overdraft position on Columbus's checking account. The remaining $10,133.06 was distributed to Columbus. However, an IRS lien of $6,300.00 had to be satisfied out of this distribution, leaving $3,833.06 available to Columbus for working capital. Because Columbus was insufficiently capitalized and because of its insolvency, both before and after this loan, Columbus filed bankruptcy proceedings in May of 1978.

In the bankruptcy proceedings involving Columbus, Marine is a general creditor with regards to the $65,000.00 loan. Marine refuses to return the $50,000.00 Certificate of Deposit to Weaver even though requested to do so.

In the District Court, Weaver claimed that he was the seller and Marine was the purchaser of the $50,000.00 Certificate of Deposit as a consequence of the pledge of that Certificate of Deposit on March 17, 1978. Weaver also claimed that he was the purchaser of a security and/or investment contract when he entered into the March 17, 1978 agreement with Columbus to share in the profits of Columbus and that if Marine was not a seller of that security, they were liable in a secondary capacity in the sale of that security to Weaver. Three separate theories of liability were set forth in the pleadings by Weaver against Marine including allegations that Marine (1) violated §10(b) of the Securities Exchange Act of 1934 (1934 Act), 48 Stat. 891, 15 USC §78j(b); (2) that Marine violated §17(a) of the Securities Act of 1933, 48 Stat. 84, 15 USC §77q(a); and (3) that Marine violated the Pennsylvania Securities Act, Pa. Stat. Ann. Tit. 70, §1-101 *et seq.* (Purdon Supp. 1980).

At the conclusion of discovery and prior to trial, Marine moved the District Court for a Summary Judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. The District Court granted same, holding that there was no genuine issue of fact supporting the claim that Weaver was either a purchaser and/or a seller of a security and/or that Marine was involved in the purchase and/or sale of securities as defined by the applicable Federal law. The Court also dismissed the pendant State Court claims. The Third Circuit Court of Appeals reversed and remanded the case to the court below holding, in summary, that the Weavers were entitled to a trial on the three theories of liability as outlined above.

REASONS FOR DENYING THE WRIT

FIRST QUESTION:

Whether Weaver's pledge of his $50,000 Certificate of Deposit to Marine, for purposes of Weaver acquiring an investment position in Columbus, constituted the purchase and sale of a security within Section 17(a) of the Securities Act of 1933 and Section 10b-5 of the Securities Exchange Act of 1934.

Weaver claimed that the pledge of his $50,000 Certificate of Deposit to Marine on March 17, 1978 constituted the purchase by Marine and sale by Weaver of a security within Section 17(a) of the Securities Act of 1933 and Section 10b-5 of the Securities Exchange Act of 1934. Upon Motion by Marine, the District Court granted Marine Summary Judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure holding, in summary, that there was no genuine issue of fact which would support a finding that this pledge constituted the purchase and sale of a security within either Act. In reversing, the Third Circuit held that there was a genuine issue of material fact as to whether or not this pledge constituted a purchase and sale of a security under either of these Acts.

In its Petition for Writ of Certiorari to this Court, Marine claims that the Third Circuit's holding that the pledge of a Certificate of Deposit could be found to be a purchase and sale of a security was contrary to holdings in the 4th, 5th, 7th and 9th Circuit Court of Appeals. All of the authorities relied upon by Marine were decided prior to the Court's decision in *Rubin v. U.S.*, _____ U.S. _____, 100 S. Ct. 698, 66 L.Ed. 2d 633 (1981).

In *Rubin v. U.S., supra,* the Court held that a pledge of worthless common stock to a bank for a commercial loan constituted the purchase and sale of a security within Section 17(a) of the Securities Act of 1933. In *Rubin v. U.S., supra,* common stock was pledged. In the present case, a six-year Certificate of Deposit was pledged. The 5th Circuit's holding in *McClure v. First National Bank of Lubbock, Texas,* 497 F.2d 490 (5th Cir., 1974), relied upon by the Marine as a holding contrary to the 3rd Circuit's holding in the present case, is now controlled by the holding of *Rubin v. U.S., supra,* in that the Court in *McClure v. First National Bank of Lubbock, Texas* held that a pledge of a security without a foreclosure on the pledge did not constitute the purchase and sale required by the Act. 497 F. 2d at pages 495, 496.

Weaver claims that he was exchanging a relatively safe investment position in a six-year Certificate of Deposit for a speculative investment position in Columbus. He claims further that the pledge of this Certificate of Deposit was in substance a purchase by Marine and sale by Weaver. It was highly unlikely that Columbus, insolvent both before and after this transaction, could repay the loan which resulted from this pledge. It was only if that loan was repaid that Marine would return this Certificate of Deposit to Weaver. Considering that as of March 17, 1978, there was little likelihood that Weaver would recover his Certificate of Deposit from Marine, Weaver's pledge of this Certificate of Deposit constituted the sale of one investment in exchange for an investment position in Columbus. Weaver was receiving no other consideration for his pledge other than an investment position in Columbus.

Other authorities relied upon by Marine in support of its proposition that the 3rd Circuit's holding is in conflict with the holdings of other Circuits are clearly distinguishable upon their facts from the present case. In *Burrus, Cootes and Burrus v. MacKethan*, 537 F.2d 1262 (4th Cir., 1976), Certificates of Investments were not pledged or exchanged by a party who was intending to make an investment in a common venture and/or a party who was exchanging one investment position for another. In *Bellah v. First National Bank, et al.*, 495 F.2d 1109 (5th Cir., 1974) at page 1116, the 5th Circuit held that the record before the Court was not adequate for that Circuit to determine whether or not the Certificate of Deposit involved the purchase and sale of a security. It therefore remanded that case to that District Court in the same fashion that the 3rd Circuit remanded this case to the Court below.

In *Canadian Imperial Bank of Commerce Trust Company v. Fingland*, 615 F.2d 465 (7th Cir., 1980), the 7th Circuit held that the purchase of a Certificate of Deposit which did not involve an investment in a common enterprise did not constitute a purchase and/or sale of a security. Weaver is not contending that the original purchase of his Certificate of Deposit from Marine two weeks prior to March 17, 1978 constituted the purchase and sale of a security within these Acts but, rather, contends that it was the exchange of his investment in this Certificate of Deposit, by way of this pledge, for investment purposes which categorizes this pledge as a purchase and sale of a security within either of the Securities Act of 1933 and/or the Securities Exchange Act of 1934.

A "substance over form" analysis was followed by the 7th Circuit in *C.N.S. Enterprises, Inc. v. G & G Enterprises, Inc.*, 508 F.2d 1354 (7th Cir., 1975) for purposes of determining whether or not the purchase and sale of an instrument issued by commercial banks involved a purchase and sale of a security within these Acts. Following a substance over a form analysis, and considering that all of the facts in the present case were to be construed in favor of Weaver on a Motion for Summary Judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure, the 3rd Circuit in the present case had to accept the evidence that Weaver was exchanging one investment position for another by this transaction. The Marine officers directly involved in soliciting Weaver's pledge testified that they considered Weaver as making a $50,000.00 investment in Columbus by virtue of this March 17, 1978 transaction.

In *Amfac Mfg. Corp. v. Arizona Mall of Tempe*, 583 F.2d 426 (9th Cir., 1978), the 9th Circuit held that a mortgage company giving a promissory note was not making an investment of risk capital because there was no expected return which was dependent upon the entrepreneurial efforts of another. However, in the present case, return of Weaver's Certificate of Deposit by Marine was entirely contingent upon the entrepreneurial efforts of Piccirillo. If Piccirillo was able to generate a profit from the pooling of his assets and the working capital which Marine was allegedly loaning to Columbus as a consequence of Weaver's pledge, then Weaver's Certificate of Deposit would have been returned. Unless Columbus generated a profit, there was no other way in which Weaver's Certificate of Deposit would be returned.

The definition of security in the Securities Act of 1933 and in the Securities Exchange Act of 1934 is extremely broad. The Securities Exchange Act of 1934 specifically includes Certificates of Deposits of the type involved in this transaction, except those whose maturity at the time of the issuance does not exceed nine months. The Certificate of Deposit pledged in the present case had a six-year maturity. There is no authority in any of the Circuits that holds that a pledge of a six-year Certificate of Deposit held for investment purposes and pledged for investment purposes is not a purchase and sale of a security within these Acts.

The anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 were designed to protect investors. *Tcherepnin v. Knight*, 389 U.S. 332 (1967); *S.E.C. v. W.J. Howey*, 328 U.S. 293 (1946). There is substantial evidence in the record to support the contention that Weaver, at the time that he was pledging this Certificate of Deposit to Marine, was participating in an investment transaction as opposed to a commercial banking transaction. The 10th Circuit in *Zabriskie v. Lewis*, 507 F.2d 546 (10th Cir., 1974), in holding that a promissory note, stock certificate, and hypothication agreement were securities protected by these Acts, focused upon the purpose of the transaction from the standpoint of the investor. 507 F.2d at pages 551 and 552. Marine's officers and Weaver believed Weaver was making an investment in Columbus by virtue of this pledge.

A pledge of a security to a bank for investment purposes constitutes the purchase and sale required by these Acts. *Rubin v. U.S., supra.* The six-year Certificate of Deposit falls within the definition of security for both Acts. Other courts have found liability under similar circumstances. *Zabriskie v. Lewis, supra.*

SECOND QUESTION:

Whether Piccirillo's written promise to pay Weaver 50% of the profits of Columbus in consideration for Weaver's pledge of his $50,000.00 Certificate of Deposit to Marine, was a security within §10b-5 of the Securities Exchange Act of 1934 and §17(a) of the Securities Act of 1933.

Contemporaneous with Weaver's pledge of his $50,000.00 Certificate of Deposit to Marine on March 17, 1978, and in consideration for this pledge, Piccirillo agreed in writing to, among other things, pay Weaver 50% of the profits of Columbus so long as the $50,000.00 Certificate of Deposit remained pledged to Marine. Weaver claimed that this written agreement to share the profits in Columbus was a security. Weaver further claimed that Marine made material misrepresentations which induced his purchase of this security.

The definition of security within the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10), is essentially the same as the definition of security in the Securities Act of 1933, 15 U.S.C. §77(b)(1). The District court held as a matter of law that this profit sharing agreement was not a security. The Third Circuit reversed, holding that it was both a certificate of interest or profit sharing agreement within *Tcherepnin v. Knight*, 389 U.S. 332 (1967); *S.E.C. v. C.M. Joiner Leasing Company*, 320 U.S. 334, 351 (1943) and/or that it could be found to be an investment contract as defined by the Court in *S.E.C. v. W.J. Howey Company*, 328 U.S. 293 (1946); *Cameron v. Outdoor Resorts of America*, 608 F.2d 187 (5th Cir., 1979).

Marine, in their Petition for Certiorari, never challenged the Third Circuit's holding that this agreement could be found to be a certificate of interest and/or a profit

sharing agreement within the holding of *Tcherepnin v. Knight, supra*, 389 U.S. at pages 338, 339. Other courts on similar facts have found such an agreement to be a certificate of interest and/or a profit sharing agreement, *S.E.C. v. Addison*, 194 F.Supp 709, 721-722 (N.D. Tex., 1979). There are sufficient facts which would allow a jury to find that Weaver's right to receive 50% of the future profits of Columbus constituted a profit sharing agreement and hence a security which is protected by both the 1933 and 1934 Acts. *Tcherepnin v. Knight, supra.*

Marine challenges the alternative holding of the Third Circuit that this profit sharing agreement could be found to be an investment contract. In *S.E.C. v. W.J. Howey Company, supra*, the Court held that an investment contract, to constitute a security protected by the 1933 and 1934 Acts, required: (1) an investment of money; (2) an investment of money into a common enterprise; (3) with profits and/or the expectation of profits resulting from the efforts of others. This definition of an investment contract has been followed and applied by various Circuits in finding that a profit sharing agreement constitutes an investment contract, *Cameron v. Outdoor Resorts of America, supra*, 608 F.2d at pages 192, 193 and/or that an agreement is not an investment contract, *Lino v. City Investing Co.*, 487 F.2d 683 (3rd Cir., 1973) at pages 691 and 692.

Considering that the Bank officials responsible for this transaction testified that Weaver was considered an investor in Columbus and that they considered his pledge of the $50,000.00 Certificate of Deposit to Marine as the amount of his investment in Columbus, Marine cannot seriously challenge the proposition that Weaver made an investment of money and/or the first element required by

S.E.C. v. W.J. Howey Company, supra. Marine claims Weaver did not make an investment into a common enterprise and that the profits, and/or expectation of future profits would not result from the efforts of others.

The holdings relied upon by Marine for the proposition that the Third Circuit's opinion in the present case is in conflict with holdings of other Circuits are clearly distinguishable on their facts. The Seventh, Third and Fifth Circuits in *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir., 1977); *Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir., 1972), *cert. denied*, 409 U.S. 887 (1972); *Wasnowic v. Chicago Board of Trade*, 352 F.Supp. 1066 (M.D. Pa. 1972), *affirmed mem.*, 491 F.2d 752 (3rd Cir., 1973), *cert. denied*, 416 U.S. 994 (1974); and *S.E.C. v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir., 1974) respectively, were considering whether or not commodity future contracts and/or margin agreements with respect to these contracts constituted a security. In each of these commodity contracts there was no pooling of assets. The chance to make future profits was not dependent upon the combination of any other parties' capital or labor with an investor's capital.

In the present case, Weaver's right to receive profits was dependent upon the combination of Weaver's investment and/or the working capital which he was injecting into Columbus by virtue of these transactions with Piccirillo's labor and assets. In effect, there was a pooling of Weaver's capital with Piccirillo's equipment and labor which was expected to produce profits in the future. Weaver could not recover his $50,000.00 Certificate of Deposit or investment, unless Columbus generated a profit to repay the loan to Marine resulting from Weaver's pledge of this Certificate of Deposit.

In *Great Western Bank and Trust Co. v. Kotz*, 532 F.2d 1252 (9th Cir., 1976), additional authority relied upon by Marine, the facts are clearly distinguishable from the present case. That claim involved a corporate note given to a bank for a 10 month line of credit. There was no agreement whatsoever to share profits. There was no investment like Weaver was making into Columbus, the return on which was contingent upon the combination of capital and labor producing profits.

Marine claims that Weaver's expectation of profits was not dependent upon the "efforts of others" within *S.E.C. v. Howey, supra.* There was no evidence that Weaver was required and/or expected to perform any labor and/or services on behalf of Columbus. At age 79, it would have been unrealistic to expect Weaver to have made any substantial efforts on behalf of Columbus. Even if it could be implied that Weaver was to render nominal services on behalf of Columbus, this would not preclude a finding that this was an investment contract. See *Lino v. City Investing Co., supra* at 487 F.2d page 692.

Marine also claims (because there was no advertising, public interest or public offering), that a private agreement to share the profits of a business in consideration for a $50,000.00 investment is not a security within either the 1933 and/or 1934 Act. Prior authority has established that claims under these Acts may be established in private face-to-face transactions providing there has been a purchase and sale of a security affecting interstate commerce. *Matheson v. Armbrust*, 284 F.2d 670 (9th Cir., 1960); *Superintendent of Insurance v. Bankers Life and Casualty Company*, 404 U.S. 6 (1971); *Affiliated UTE Citizens v. United States*, 406 U.S. 128 (1972).

Marine also claims that Marine had no knowledge of the Piccirillo agreement with Weaver and the Third Circuit failed to require Weaver to allege scienter and/or allege an intention to deceive in violation of the Court's holding in *Ernst and Ernst v. Hochfelder*, 425 U.S. 185 (1976).

Marine recognized that Weaver was an investor in Columbus and that the pledge of his Certificate of Deposit represented an investment transaction. Weaver alleged in his complaint and supporting affidavit that "in connection with" that investment transaction, Marine made several misrepresentations to induce Weaver to invest in Columbus even though Marine had actual knowledge, not disclosed to Weaver, that Columbus was insolvent both before and after the March 17, 1978 transactions. A fact finder could easily conclude that the misrepresentations made by Marine were intentional and designed to secure Weaver's $50,000.00 Certificate of Deposit so that Marine could satisfy their outstanding and unpaid loans with Columbus and satisfy the longstanding overdraft of Columbus's checking account for which there was no remedy from the standpoint of Marine other than an investment of capital into Columbus. Weaver is not claiming that Marine acted negligently, but rather claims that they intentionally defrauded him out of his $50,000.00 Certificate of Deposit and all of the above facts satisfy the scienter requirements set forth in *Ernst and Ernst v. Hochfelder*, 425 U.S. 185 (1976).

The Third Circuit's holding in the present case will have little or no impact on the banking industry to the extent that the banks engage in traditional banking transactions. The transactions which give rise to the present case and holding are not traditional commercial

banking transactions but rather are investment transactions. Marine actively involved itself in soliciting Weaver to make an investment in Columbus because traditional banking procedures had failed to remedy the failure of Columbus to repay Marine as required and the failure of Marine to properly protect itself in extending its line of credit to Columbus. When banks become actively involved in investment transactions, and make material misrepresentations with respect thereto, they become liable under either the 1933 and/or 1934 Act. *Affiliated UTE Citizens v. United States*, at 406 U.S. at pp. 152, 153.

Conclusion

The decision of the Third Circuit that the pledge of Weaver's $50,000.00 Certificate of Deposit to Marine created a genuine issue of material fact as to whether the transaction constituted a purchase and sale of a security under the 1933 and 1934 Acts is consistent with this Court's most recent decision in *Rubin v. U.S., supra.*

The holding of *Rubin v. U.S.* not cited by Marine, controls and disposes of the first question presented, namely that the pledge of the Certificate of Deposit for the loan constitutes the purchase and sale of a security under the Securities Acts.

There is substantial record evidence to support the Third Circuit's conclusion that the Piccirillo agreement was a security either because it met the definitions of a profit sharing agreement as defined by *Tcherepnin v. Knight, supra*, and *C.M. Joiner Leasing Company, supra*, and/or it satisfied the three elements of an investment contract as explained in *S.E.C. v. W.J. Howey Company*,

supra. It is conceded by Marine at this stage of the proceedings that Weaver was a purchaser of the Piccirillo agreement and that Marine made material misrepresentations that induced its sale.

Lastly, the cases cited by Marine for the proposition that the decisions of the Circuit Court are in conflict on both questions can be reconciled by a close scrutiny of the factual patterns of each, particularly in light of this Court's decision in *Rubin v. U.S.*

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